

October 21, 1996

VIA Hand Delivery

Docket Office
California Public Utilities Commission
505 Van Ness Avenue, Room 2001
San Francisco, California 94102

Re: R.94-04-031/I.94-04-032

Dear Docket Clerk:

Enclosed for filing in the above-entitled matter are the original and five copies of the **COMMENTS OF THE CALIFORNIA ENERGY COMMISSION IN RESPONSE TO THE SEPTEMBER 30, 1996 COORDINATING COMMISSIONER RULING**. Please return the extra copy in the enclosed, stamped, self-addressed envelope. Thank you for your attention to this matter.

Very truly yours,

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Enclosures

cc: Restructuring Service List

**BEFORE THE CALIFORNIA PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking)	
The Commission's Proposed Policies)	
Governing Restructuring California's)	R.94-04-031
Electric Services Industry and)	(Filed April 20, 1994)
Reforming Regulation)	
_____)	
Order Instituting Investigation on)	
the Commission Proposed Policies)	
Governing Restructuring California)	I.94-04-032
Electric Services Industry and)	(Filed April 20, 1994)
Reforming Regulation)	
_____)	

**COMMENTS OF THE CALIFORNIA ENERGY COMMISSION
IN RESPONSE TO THE SEPTEMBER 30, 1996
COORDINATING COMMISSIONER RULING**

October 21, 1996

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I. INTRODUCTION AND OVERVIEW

The California Energy Commission (CEC) submits the following comments in response to Commissioner Fessler's September 30, 1996 Coordinating Commissioner Ruling. In that ruling, Commissioner Fessler invites comment on four specific issues to assist the California Public Utilities Commission (CPUC) in its resolution of pending motions for rehearing of D.95-12-063. The CEC takes this opportunity to comment in response to issue b, which addresses the following issue:

Our Policy Decision requires that the investor-owned utilities "bid all of their generation into the Power Exchange and satisfy their need for electric energy on behalf of their full service customers with purchases made from the Exchange" during the five-year transition period. (Policy Decision, p. 51 (mimeo).) Parties should consider impacts, if any, of AB 1890 on this requirement. Parties are also requested to provide additional detailed information supporting the benefits and detriments to California ratepayers of this requirement.

The CEC strongly supports the "bid-in/buy-from" requirement imposed on investor-owned utilities (IOUs) for the five-year transition period as essential for the development of a robust transparent hourly spot market, which is the purpose and function of the Power Exchange (PX).

It is extremely important that there be sufficient activity through the PX for market participants to have confidence that the PX market clearing price reflects a reasonable degree of competitiveness. This requires that there be a sufficient amount of supply of, and demand for, PX energy. Requiring IOUs to meet demand not met through physical direct access (PDA) with PX energy ensures some level of demand for PX energy. Requiring IOUs to bid available generation into the PX, ensures the availability of supply to meet demand. Of course, it is hoped that non-IOU generation will compete with the IOUs to meet PX demand. Due to the amount of must-take and must-run generation during the first years of operation, there is a legitimate concern

expressed by the CEC and other parties that the PX market will be thin as a result. Abandoning the "bid-in/buy-from" requirement will only exacerbate these concerns and raise yet others.¹

II. PURPOSE OF THE POWER EXCHANGE

The PX and the Independent System Operator (ISO) are the essential structural elements of the CPUC's preferred market structure. The purpose and justification for creating the PX, and imposition of a temporary bid-in/buy-from requirement, is discussed in detail in the D.95-12-63, the CPUC's Preferred Policy Decision.

A. The Virtue of a Robust Transparent Spot Market

Generators will be able to "compete on the basis of short run incremental electricity costs in an open setting and on what is literally a level playing field." (Policy Decision, p. 54.) The transparent PX pricing will provide a market signal for potential non-IOU sellers to determine whether to compete in the PX or to enter into the PDA market and/or offer contracts-for-differences (CfDs). (Policy Decision, p. 55.) Moreover, the market signal will provide information concerning the need for development of new generation.

Buyers with interval meters will be able to respond to hourly prices in order take advantage of low cost electricity during periods of low demand and avoid high cost,

¹ The CEC does not address the legal arguments urged by the IOUs and other parties that the bid-in/buy-from requirement, and other elements of the CPUC preferred market structure, violates the Commerce Clause of the United States Constitution. Although they claim that the CPUC is without jurisdiction to require IOUs to implement the market structure, the IOUs have agreed to do so "voluntarily" provided they recover all stranded costs. So long as the IOUs continue to act voluntarily, Commerce Clause arguments are not ripe.

high demand time periods. In addition, full-service customers will benefit from the down-ward pressure on price that vigorous competition should entail. Buyers will then be able to compare the PX price, an/or their total bill for PX energy, with alternatives such as PDA or CfDs. (Policy Decision, pp. 56-57.)

The prices revealed in the PX can also be used to determine the value of the IOUs stranded assets. The availability of a sound market proxy would "reduce the scope and burden of the regulatory issues associated with determination of the assets which are non-competitive" (Policy Decision, pp. 51-52.)

B. Justification for Bid-in/Buy-from Requirement

The CPUC's Preferred Policy Decision offers the following justifications for imposition of the bid-in/buy-from requirement for the transition period:

During the transition period both the transparency and reliability of the pricing signals will be seriously compromised unless the jurisdictional utilities are obligated to bid their generation units into the Exchange and procure the electric energy needed to supply their full service customers from it. Consider the most extreme example of an Exchange which is wholly voluntary from the perspective of the jurisdictional utilities on day one. Such a strategy would enable the potential market participants with the most concentrated market power to buy or sell electric energy through bilateral contracts. There would be no price revelation and consequently no price signals manifest to any party who was not a counterpart to such a contract. Even contracting parties would be mostly in the dark for they would have no direct knowledge of the terms contained in other deals.

If the utilities opted to make the bulk of their purchases on behalf of full service customers through bilateral contracts, those customers most vulnerable to an abuse of market power would have no means of tracking the cost of the electric power. Only by engaging in contentious reasonableness reviews could this Commission eventually establish information which, by that point, would be months if not years old. The virtual direct access option would be taken away from full service customers or rendered functionally useless given their inability to follow real time price signals. The decision of whether to opt for a contract for

differences or to bear the cost of a direct access contract would likewise be compromised by an inability to compare the advantages and disadvantages of these strategies to a transparent alternative.

Beyond the issues of consumer protection and customer choice, there is the legitimacy of the competition transition charge and its acceptance as a non-bypassable obligation by all classes of end users. The issue of generation assets alleged to have been stranded would now be plagued with doubt and uncertainty at the precise time when this Commission would be seeking to ensure the acceptance and collection of a non-bypassable competition transition [charge]. Again, complex and probing regulatory proceedings might eventually determine the reasonableness of these claims presented by our jurisdictional utilities but the time delay would protract the transition period and move us away from reliance upon market mechanisms.

On the surface many of these concerns would seem to be mitigated if we indulge the assumption that the jurisdictional utilities would shift only a portion of their purchases and sales away from the transparent Exchange market. But to the extent that they diverted their business they would lessen the confidence on the part of all market participants that the volume of Exchange transactions was sufficiently robust as to convey reliable pricing signals. In economic literature this problem is identified as one of “thin markets.” Such a development could actually complicate California’s experience with the transition period rather than facilitate it.

We can envision regulatory proceedings in which the market signals emerging from such a partially used Exchange would be blended with what were alleged to be proxy indicators developed from wholly or partially unverified sources. Any verification efforts made during the course of a contested proceeding would doubtless compromise the proprietary interests of the non-utility participant in such transactions adding yet another layer of conflict. Equally important, it would not resolve the issue of the appropriate charges to be passed onto to full service customers by the jurisdictional utilities, nor would it withdraw from the realm of conjecture the fairness with which they marketed generation sales which then resulted in a claim for compensation under the transition charge. In the final analysis adding layers of regulatory fixes strikes us a decidedly regressive response to a proceeding launched in the bid to foster and then rely upon market forces. [Policy Decision at pp. 58-60]

These justifications remain valid. We address the bid-in and buy-from requirements separately.

1. The Bid-In Requirement is Necessary and Appropriate

The following scenario offers additional justification for the bid-in requirement. Consider the situation where an IOU elects to bid an expensive plant into the PX.² If those plants are needed to meet demand, the market clearing price will likely be higher than it would have been had the IOU elected to bid its lower cost plants. Therefore, full-service IOU customers served through the PX will have higher energy costs as a result.

Now suppose the IOU has also entered into a PDA contract for the out-put of the less expensive plants. If the PDA contract prices energy at below the PX price, a "sweetheart" deal, one group of IOU customers will have been given a discriminatory discount. Moreover, the difference between the PX price and the PDA contract price will not be available to reduce the CTC, because it has gone into the pockets of the PDA customer. This will result in a higher CTC obligation for all customers. Thus, IOUs should not be allowed the option not to bid its cheaper resources into the PX.

Several parties argued that it was poor policy to prohibit the IOUs participating in the existing wholesale market through the types of contracts currently in existence. Indeed, at some times of the year California has historically been an exporter of electricity. Nothing prohibits a wholesale buyer from submitting a demand bid to the

² The IOUs will not be allowed in any case, i.e. either during or after the transition, to "purchase the output of a generation facility that is under their own or any of their affiliates' ownership." (Policy Decision, p. 71.)

PX to take advantage of excess supply in California, for at times of excess supply, the PX market clearing price should be attractively low.

Others suggest that the bid-in requirement would preclude IOUs from entering into PDA contracts to sell at above the PX market clearing price. If above-market contracts were allowed, the CPUC would have to be able to discover the price so that the CTC could be reduced accordingly. Buyers, of course, attempt to avoid entering into such contracts. Due to the likely reality that there will be few such above-market contracts and the need for CPUC review to ensure appropriate CTC accounting, it would be impractical to allow a limited exception for above-market deals.

2. The Buy-From Requirement is Necessary and Appropriate

The buy-from requirement is the critical element to establish demand for PX energy at the beginning and during the first years of operation of the new energy market. (In this regard, the buy-from requirement is more important than the bid-in requirement, because sellers can be expected to meet demand whether or not the IOUs are required to bid in all their resources.) PX activity is necessary to create the hourly spot prices that are to be communicated to consumers through a metering and information system that is being developed. Thus, all consumer demand not being met through must-take, must-run and PDA arrangements must be met with PX energy in order for the PX to function.

Certain parties assert that the buy-from requirement will prevent the IOUs from taking advantage of cheap out-of-state electricity when it is available, thereby lowering energy costs for California consumers. Any out-of-state seller can take advantage of California's PX by bidding supply. Cheap supply can be bid at low cost, will very likely be dispatched, and lower the PX market clearing price at the same time. This will result in lower energy prices for customers paying PX energy prices.

Another advantage contemplated by the CPUC, is the avoidance of prudence review for PX energy. If IOUs were allowed to purchase outside the PX, the CPUC would be required to continue its regulatory oversight of IOUs' purchases. Indeed, the D.95-12-063 urges the IOUs to continue to serve full-service customers with PX energy to avoid the need for CPUC scrutiny of purchases out-side the PX even after the transmission period. (Policy Decision, p. 70 ("utility purchases through the Power Exchange will be considered prima facie prudent)).

III. AB 1890 REQUIRES CREATION OF THE POWER EXCHANGE

AB 1890 requires implementation of the market structure set forth in the CPUC's Preferred Policy Decision. Section § 330(l)³ asserts that the CPUC properly concluded that "competition will best be introduced by the creation of an Independent System Operator and an independent Power Exchange." Sections 334-56, expressly call for the establishment of the PX and the ISO. Section 355 specifically requires that the PX "shall provide an efficient competitive auction, open on a nondiscriminatory basis to all suppliers, that meets the loads of all exchange customers at efficient prices." Article 6, §§ 360-377, charges the CPUC with ensuring, among other things, that the IOUs pursue all avenues at the Federal Energy Regulatory Commission to obtain approval for creation of the PX and ISO. AB 1890, § 365(a).

Further, § 367(c) requires utilities to recover "all 'going forward' costs of fossil plant operation, including operation and maintenance, administrative and general, fuel and fuel transportation costs, [to] . . . solely from independent Power Exchange revenues or from contracts with the Independent System Operator"

In addition, § 390(c) also contemplates that payments to non-IOU generators will be based on the PX price, once the PX is running to the satisfaction of the CPUC,

³ All statutory references are to new Sections of the Public Utilities Code enacted by AB 1890.

provided one of two conditions prevails. The PX price can be used if IOUs have divested 90% of their gas fired plants, or, IOU fossil plants have been approved to sell energy at market based rates and are able to recover their costs through the PX (or with contracts with the ISO). "Until the requirements of [§ 390](c) have been satisfied," CPUC will have to compute short run avoided cost energy payments pursuant to a regulatory formula. AB 1890, § 390(b). The purpose of electricity industry restructuring is to rely on market forces, instead of such ratemaking practices as regulatory calculations of payments based on cost formulae.

Based on the forgoing, it is clear that the legislature intended that the PX not only be created, but that it function efficiently and competitively, and ultimately become the market proxy for determining short run avoided cost payments. This can only happen if the PX serves sufficient demand. Further, IOUs are required to bid their generation into the PX, unless paid pursuant to an ISO contract. Since the CPUC is charged with the responsibility for facilitating implementation of the new market structure, the CPUC should not relax either the bid-in or buy-from requirements during the five-year transition period. The CEC urges the CPUC and all market participants to give PX a chance.

Dated: October 21, 1996

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